

Internal Revenue Service

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Decedent =
Trust =

Attorney =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
State =
State =
Law
Citation =

Dear :

This is in response to a letter dated July 9, 2008, and subsequent correspondence, requesting a ruling concerning the application of section 2056 of the Internal Revenue Code.

On Date 1, Decedent, who was then married, executed the Trust, a revocable trust. The Trust provided Decedent's surviving spouse with a qualifying income interest for life, within the meaning of section 2056(b)(7)(B)(ii). Decedent was predeceased by his spouse, and the Trust was later amended to omit the marital provisions. On Date 2, as Decedent contemplated remarriage, Attorney prepared a draft amendment to the Trust to again incorporate, at Article 7, provisions to provide a surviving spouse with a qualifying income interest for life. Attorney accompanied the draft with a letter explaining the marital provisions, including the deferral of estate tax that was inherent in these provisions. Article 7 was later amended to include, for the first time, a limited power of appointment in a surviving spouse. Article 7 contains specific guidance on the

manner in which the power is to be exercised, i.e., in a will timely admitted to probate. Although the language in Article 7 provides specific instructions relating solely to the exercise of a testamentary power, the amendment provided that the power was exercisable “during lifetime or by Will.” On Date 3, Decedent remarried, and on Date 4, Decedent executed the amended Trust.

Decedent died on Date 5. Shortly thereafter, Attorney provided the trustees with a written explanation of the Trust, including the marital provisions and the possibility of a testamentary exercise of the special power. The explanation made no reference to the lifetime exercise of the power. Indeed, Attorney had never discussed the possibility of a lifetime exercise with Decedent, and was unaware of the presence of the phrase “during lifetime” in the Trust until it was brought to his attention more than nine months after Decedent’s death by a representative of one of Decedent’s beneficiaries.

On Date 6, the trustees of the Trust filed a petition in the probate court to reform the Trust. Pursuant to the petition, the court issued an order granting reformation, striking the phrase “during lifetime or” from the Trust on Date 7.

You have requested a ruling that the property interest created under Article 7 of Trust as reformed constitutes qualified terminable interest property for purposes of section 2056(b)(7).

Section 2001(a) of the Internal Revenue Code imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2056(a) provides that, for purposes of the tax imposed by section 2001, the value of the taxable estate is to be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes or has passed from the decedent to the surviving spouse.

Section 2056(b)(1) provides generally that no deduction is allowed for an interest passing to the surviving spouse if, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, the interest will terminate or fail and on such termination or failure, an interest passes to any person other than the surviving spouse or the estate of the surviving spouse. See sections 2056(b)(1)(A) and (B).

Section 2056(b)(7)(A) provides that, in the case of qualified terminable interest property, the entire property is treated as passing to the surviving spouse for purposes of section 2056(a) and no part of the property is treated as passing to any person other than the surviving spouse for purposes of section 2056(b)(1)(A).

Section 2056(b)(7)(B)(i) defines qualified terminable interest property as property: (1) that passes from the decedent, (2) in which the surviving spouse has a qualifying

income interest for life, and (3) to which an election under section 2056(b)(7)(B)(v) applies.

Section 2056(b)(7)(B)(ii) provides that the surviving spouse has a qualifying interest for life if the surviving spouse is entitled to all income from the property, payable annually or at more frequent intervals, or has a usufruct interest for life in the property, and no person has a power to appoint any part of the property to any person other than the surviving spouse. However, a power to appoint property to a person other than the surviving spouse will not disqualify the interest if the power is exercisable only at or after the death of the surviving spouse.

Section 2056(b)(7)(B)(v) provides that an election under section 2056(b)(7) with respect to any property shall be made by the executor on the return of tax imposed by section 2001. Such an election, once made, is irrevocable.

Section 2044 provides that the value of the gross estate includes the value of any property in which the decedent had a qualifying income interest for life and with respect to which a deduction was allowed for the transfer of the property to the decedent under section 2056(b)(7).

State Law provides, in part, that the probate court has jurisdiction over proceedings concerning the internal affairs of trusts including the power to ascertain beneficiaries, to determine any question arising in the administration or distribution of any trust including questions of construction of trust instruments, to instruct trustees, and to determine the existence or nonexistence of any immunity, power, privilege, duty or right.

When construing a trust, a court is guided by principles relating to the interpretation of trusts as well as those relating to the interpretation of wills. A fundamental rule when construing trusts is that the intention of the settlor as expressed in a trust instrument shall prevail unless inconsistent with some positive rule of law. Additionally, in construing a trust document to determine the settlor's intent, the instrument must be read as a whole, not in fragments. Citation.

Here, all prior versions of Trust, as it existed during periods when Decedent was married, provided a marital bequest that complied with the provisions of section 2056(b)(7). Attorney provided the probate court with an affidavit in which he stated that he never discussed the possibility of a lifetime exercise of the special power with Decedent, and was unaware of the "during lifetime" phrase until nearly a year after Decedent's death. Attorney states that the inclusion of the language was a mistake on his part in drafting the instrument. These assertions are supported by the fact that while the Trust gives specific direction as to the timing and manner of a testamentary exercise of the power, it is silent on the manner in which the power would be exercised during the lifetime of the surviving spouse.

In view of the above, we conclude that the reformation by the probate court is consistent with the applicable State law that would be applied by the highest court of State. Accordingly, the property interest created under Article 7 of the Trust as reformed constitutes qualified terminable interest property for purposes of section 2056(b)(7). Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

JAMES F. HOGAN
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure (1)

cc: